

Background

The Board

The Montana Public Employees' Retirement Board (Board) consists of seven members, appointed by the Governor for 5-year staggered terms.

Carole Carey (President) – Active Member (Carter County Clerk of Court)
John Paull (Vice President) – Active Member (Firefighter, Butte)
Troy McGee – PERS Retired Member (Helena)
Robert Griffith – Member at Large (Retired Highway Patrol, Helena)
Jay Klawon – Investment Advisor (Edward Jones, Hamilton)
Terrence Smith – PERS-DCRP Active Member (Bozeman)
Elizabeth Nedrow – Member at Large (Attorney, Billings)

Board Mission Statement

*The Montana Public Employees' Retirement Board
will fiduciarily administer its retirement plans and
trust funds, acting in the best interest of the
members and beneficiaries.*

Fiduciary Duty

The Public Employees' Retirement Board has a duty to conform to "fundamental fiduciary duties of loyalty and impartiality".

- A fiduciary shall discharge duties with respect to a retirement system:
 - Solely in the interest of the participants and beneficiaries.
 - For the exclusive purpose of providing benefits to participants and beneficiaries.
 - Impartially, taking into account any differing interests of participants and beneficiaries.
 - Adherence to the duty of loyalty should prohibit all transactions posing conflicts of interest.

MPERA

The Montana Public Employee Retirement Administration consists of 35 management and administrative staff to the Board.

- MPERA does not invest the pension trust funds. That is done by the Montana Board of Investments. We are currently working with the BOI to review asset allocations and reduce investment risk through diversification.
- MPERA does administer the money in the pension trust from a public employee's first payday until they or their beneficiary receive their last guaranteed benefit payment.
- MPERA administration is inexpensive. Administrative costs for FY 2006 were \$3.69M for the management of \$4.5B of assets.
- MPERA collects contributions each payday for 31,000 active members from 550+ state and local government employers.
- MPERA pays benefits to 18,500 retirees and dependents each month.

The Retirement Plans

These core services are provided to members and employers in 10 distinct state and local retirement plans, each of which are qualified under federal tax law to defer income taxes until a benefit is received:

Public Employees' Retirement System (PERS)

– *Defined Benefit Retirement Plan (DBRP)*

– *Defined Contribution Retirement Plan (DCRP)*

Judges' Retirement System (JRS)

Highway Patrol Officers' Retirement System (HPORS)

Sheriffs' Retirement System (SRS)

Game Wardens' and Peace Officers' Retirement System (GWPORS)

Municipal Police Officers' Retirement System (MPORS)

Firefighters' Unified Retirement System (FURS)

Volunteer Firefighters' Compensation Act (VFCA)

State Deferred Compensation (457) Plan

All plans are defined benefit plans except the PERS-DCRP and the 457-Deferred Compensation Plan. The PERS-DCRP was implemented July 1,

2002. On the date the plan started, all current employees had 12 months to choose to remain in the DBRP or transfer to the DCRP. New hires in PERS-eligible positions have the option of choosing participation in either the DBRP or the DCRP. University employees also have a third option of joining the Optional Retirement Program (ORP) administered by the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF).

Only approximately 4% of the PERS eligible members have elected the DCRP. This may be due to the timing of the new plan with the bear market and the fact that PERS active members are generally older and are less likely to take risks. A defined contribution member is responsible to choose their own investments from a list of options.

In the Defined Benefit plans, pension trust funds are well-funded when there is enough money in reserve to meet all expected future obligations to participants. The Board's funding objective is to meet long-term benefit promises through contributions that remain approximately level as a percentage of member payroll.

The previous bear market had a negative affect on earnings and although recovery has been slow, we anticipate that over the long-term the earning rates will continue to meet the actuarial assumed rate of 8 percent.

Requirement to be Actuarially Funded

- The Montana Constitution (Article VIII, Section 15)
- State Law (§19-2-405, MCA) and
- The Governmental Accounting Standards (Statement #25)

all require that the retirement systems be funded on an actuarially sound basis. Also, Montana Code requires the Board to maintain a stable standard of living:

“The board shall review the sufficiency of benefits paid by the retirement system or plan and recommend to the legislature those changes in benefits in a defined benefit plan or in contributions under the defined contribution plan that may be necessary for

members and their beneficiaries to maintain a stable standard of living.” (§19-2-403 (9), MCA).

Based on the report of our actuary for June 30, 2006, one of the eight defined benefit plans (JRS) had surplus funding and three of the eight defined benefit plans (PERS, SRS and GWPORS) have an actuarial liability that does not amortize over the required 30 years. Legislation seeking an increase in employer contributions in those three systems was sought in the 2005 Legislative Session and drafted for the Special Session. The other defined benefit plans are all adequately funded, with actuarial liabilities that amortize within the 30 year limit.

Key Actuarial Terms

Normal Cost – The cost assigned to a member that would meet the continuing costs of that particular benefit, if contributed each year starting from the date of membership. The average cost of membership. The value of benefits expected to be received over the future working lifetime of current active members.

Actuarial Liability – The assets required to pay off the benefit obligations already accrued in a pension plan by the current members and retirees.

Actuarial Value of Assets – Market value of assets smoothed over four years.

Unfunded Actuarial Liability (UAL) – The excess, if any, of the Actuarial Liability over the Actuarial Value of Assets.

The Issue

3 of the 10 retirement systems administered by the Board are not funded on an actuarially sound basis:

Public Employees’ Retirement System (PERS)
Game Wardens’ & Peace Officers’ Retirement System (GWPORS)
Sheriffs’ Retirement System (SRS)

What does it mean to be actuarially sound?

19-2-409. Plans to be funded on actuarially sound basis -- definition. As required by Article VIII, section 15, of the Montana constitution, each system must be funded on an actuarially sound basis. For purposes of this section, "actuarially sound basis" means that contributions to each retirement plan must be sufficient to pay the full actuarial cost of the plan. For a defined benefit plan, the full actuarial cost includes both the normal cost of providing benefits as they accrue in the future and the cost of amortizing unfunded liabilities over a scheduled period of no more than 30 years. For the defined contribution plan, the full actuarial cost is the contribution defined by law that is payable to an account on behalf of the member.

What does that mean for the three systems that aren't actuarially sound? – employer and employee contributions coming in do not cover **both** the cost of the benefits accrued today for each member of the system **and** the cost to amortize an unfunded liability over a period of 30 years or less. The unfunded liability and amortization period can be thought of in terms of a mortgage.

Status of Unfunded Systems			
June 30, 2006			
	PERS	GWPORS	SRS
Unfunded Actuarial Liability	\$441.5M	\$5.4M	\$8.8M
Years to Amortize	Infinite	32.4	Infinite
Estimated Shortfall in Contributions	1.01%	0.04%	1.84%
Increase 7/1/07	0.56%	0.04%	1.03%
Increase 7/1/09	0.57%	-	1.02%
Lump Sum Needed for 30 year amortization as of 6/30/07	\$185M	\$219,000	\$15M

How did we get here?

The largest contributing factor is the

- Dramatic decline in domestic equity markets from 2000 through 2002 – this decline affected all retirement systems alike.
- Largest market decline in 60 years, since the Great Depression.
- Very slow recovery.
- Investment losses caused a decrease in assets

In addition the Guaranteed Annual Benefit (GABA) increased our liabilities. When the Guaranteed Annual Benefit passed by the Legislature, most plans were near or over 100% funded. The Board kept ½ of the \$570M surplus in PERS as a reserve when the GABA was increased in 2001.

Importance of Investments

- Largest Source of Funding
- Investment Returns Fund the Benefits
 - In PERS ER and EE contribution make-up 25%. Almost 75% of income relies on investment returns.
- Powerful, far reaching effect
- Volatile
- Need time grow – over the career-life of the employee

Board Resolution

Current members and retirees have a contract right to the benefits in statute on their date of hire.

“Benefits and refunds to eligible recipients are payable pursuant to a contract as contained in statute. The contract is entered into on the first day of a member’s covered employment and may be enhanced by the legislature.”
(§19-2-502(2), MCA)

Therefore, prospective changes that reduce retirement benefits are limited to new hires. New hires do not create unfunded liability; in fact, retirement systems depend on some contributions of future members’ salaries to pay for the existing liability.

Due to the nature of retirement plans, it will take a long time to see the results of any changes to retirement plan design on the actuarial unfunded liability.

It is the Board's policy to not support benefit enhancements that do not include a funding mechanism. The Board does not want to diminish the plan design or create disparity within membership. It is also the Board's policy to maintain a sustainable benefit level to our members. Retirement plans are a part of the benefit package provided by employers. Promoting a good retirement plan helps with:

- Recruitment
- Retention
- Rewards Loyal Service and
- Makes Retirement Possible.

Board-Proposed Legislation

The Board is proposing 3 pieces of legislation. All of these proposals have passed review of the State Administration and Veterans' Affairs (SAVA) Interim Committee.

HB 159 – Funding Bill (sponsored by Representative Carol Lambert, Senator Larry Jent) – Addresses the actuarial soundness of PERS, GWPORS and SRS.

- Increases the PERS, GWPORS & SRS employer contribution rates.
- The PERS and SRS contribution rate increases will be phased in, allowing for another actuarial valuation between the rate increases and to ease the burden on the employers.
- Includes a statutory appropriation for the increase in PERS employer contribution rates for school districts to eliminate a direct hit to property taxes.
- Includes a sunset clause to continue reviewing and eliminate the increase once the systems are able to pay off unfunded liabilities within 25 years or less.

HB 125 – Repayment of the DCRP Loan (sponsored by Representative Dave Kasten) – Requests reimbursement for the implementation costs of the PERS – Defined Contribution Retirement Plan (PERS-DCRP).

- The PERS-DCRP was established by the Legislature.
- The Legislature is the sponsor of the retirement plan.
- The cost to establish a new retirement program should be the responsibility of the State of Montana - the entity that enacted the new program.
- The original legislation included the cost of implementation was amended out prior to passage.
- Only 3% of eligible members chose the DCRP option, 20-25% was anticipated. Repayment of the startup cost loan of \$1.5M is an unexpected hardship on the small number of members in the PERS-DCRP.
- Similar legislation was proposed during the 2005 Legislative Session and was approved by the SAVA Committee.
- The repayment of the DCRP Loan is also included in HB 2. The Board is proposing this bill as a back-up if needed.

HB 129 – General Revisions Bill (sponsored by Representative Dave Gallik) – Each year the Board proposes a General Revisions bill to amend the retirement statutes.

- The MPERA staff keeps a running log of statutes that may require:
 - clarification
 - provide consistency
 - comply with changes to Federal legislation and
 - comply with the Internal Revenue Service.
- There is no fiscal impact to this bill.